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SUBJECT: NEPAL'S ECONOMIC SURVEY DEPICTS DISMAL ECONOMY

REF: KATHMANDU 1688

Classified By: Charge d'Affaires Nicholas Dean. Reasons 1.4 (b/d).

SUMMARY

1. (C) Finance Minister Ram Sharan Mahat recently presented to Parliament Nepal's annual Economic Survey Report for Fiscal Year (FY) 2005-2006, which highlighted decreases in Gross Domestic Product (GDP) and the agricultural sector and a rise in inflation. A nominal increase in per capita income was due to foreign remittances. The report states that in FY 2005/06 the number of schools decreased, only 18 kilometers of new roads were built, and no power generation capacity was added. The report also noted the slow pace of development spending over the first eight months of the year, which some experts say will not look as bad once the final fourth quarter figures are received. End Summary.

ECONOMIC PERFORMANCE UNSATISFACTORY

2. (U) On July 11, Finance Minister Ram Saran Mahat presented Nepal's Economic Survey Report for FY 2005/06 to Parliament. (Note: Nepal's fiscal year runs from July 15 through July 14. End Note.) The report depicts the dire state of the country's strife-torn economy. According to the report, Nepal's GDP is expected to grow by only 1.9 percent in FY 2005/06, compared to 2.7 percent in FY 2004/05. The survey shows that per capita income increased by USD 20 in FY 2005/06 to USD 322. This nominal growth in per capita income can be attributed to the approximately USD 1 billion in foreign remittances pumped into the economy last year. The rate of inflation was more than 8 percent, compared to 4.6 percent in FY 2004/05.

3. (C) According to Bishwambher Pyakuryal, President of Nepal Economic Association and a Professor of Economics, in the last four consecutive years of the Tenth Five-year Plan (2002-07), the average economic growth rate was below 3 percent. He said that in the tenth plan period, the projected growth rate of the economy was 4.5 to 6.2 percent. Pyakuryal noted that the performance of Nepal's economy was quite disappointing even compared to the lower end of the

projected growth rate.

AGRICULTURE SECTOR GROWTH SLOWS

14. (C) The agriculture sector, which is the mainstay of the Nepalese economy and contributes roughly 40 percent of GDP and 76 percent of employment, grew only 1.7 percent, compared to 3 percent in FY 2004/05. The growth in the agriculture sector was less than the average growth in population, which was 2.2 percent, and according to Pyakuryal, is indicative of poor agricultural planning by the government. Roshan Bajracharya, Senior Economist at the World Bank, explained that a country that gets 40 percent of its GDP from the agriculture sector will always find problems in its economic development. All other financial sectors combined, however, improved marginally to 2.8 percent growth, compared to 2.1 percent in FY 2004/05, but remained much below growth made in previous years.

SOCIAL SECTOR BEARS THE BRUNT OF MAOIST CONFLICT

15. (SBU) The Economic Survey Report shows dismal progress in the social sector in FY 2005/06. The Maoist insurgency, coupled with a volatile political situation, took a heavy toll on the social sector. According to the report, the number of schools decreased by six percent and no new hospitals came into operation during the year. Development of infrastructure such as roads and power-generation plants was almost non-existent in FY 2005/06. The government built only 18 kilometers of new roads, and did not add even one megawatt of power generation to the existing capacity.

MIXED VIEWS ON DEVELOPMENT SPENDING

16. (C) Shankar Sharma, Former Vice Chairman of the National Planning Commission, noted that, while the growth rate of the economy was unsatisfactory, the report only covered development work done in the first eight months of the fiscal year. Sharma explained that the government normally did most of its development spending in the fourth quarter of the fiscal year. He opined that the situation would not look as bad as it appeared from the figures available at this stage (reftel). However, Bajracharya stressed that the lack of resolve on the part of political leaders and the slow moving attitude of the bureaucracy increasingly caused low release and allocation of development funds.

COMMENT

17. (C) The new government is plagued by the twin challenges of trying to create a new democratic Nepal and putting the battered economy back on track. The lack of sufficient financial resources to kick-start economic activity continues to be a major snag for future economic growth. Additionally, the government needs to take steps to boost investor confidence in Nepal.

DEAN